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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1956

No. 318

ESTATE OF ARTHUR SWEET, DECEASED, TRACY-COLLINS TRUST, ADMINISTRATOR,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit.

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit.

To the Honorable, the Chief Justice, and to the Associate Justices of the Supreme Court of the United States:

The Petitioner herein respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit affirming a decision of the Tax Court of the United States.

Jurisdiction.

The judgment of the United States Court of Appeals for the Tenth Circuit was entered on the 26th day of May, 1956. Thereafter, the said court on the 28th day of June, 1956, made and entered its Order denying Petitioner's Petition for Rehearing. The jurisdiction of this court is invoked under provisions of 28 United States Code,

Section 1254, Subsection 1, and pursuant to Rule 19, Subsection 1b of the Rules of the Supreme Court of the United States, adopted April 12, 1954.

Citations to Opinions Below.

The Findings, Opinion and Decision of the Tax Court is reported in 24 T. C. 488, and is set forth in the Transcript of Record at pages 29 to 40, inclusive.

The Opinion of the Court of Appeals will be reported in 233 F. 2d ..... and for the convenience of the court is printed in Appendix A attached hereto.

Statutes and Regulations Involved.

The statutes and regulations involved relate to Section 812(e)(1)(A, F, and H) of the Internal Revenue Code of 1939, as amended by Section 361 of the Revenue Act of 1948, Ch. 168, 62 Stat. 110.

Statement of the Case.

The nature of the controversy in the above-captioned matter before the Tax Court of the United States and before the United States Court of Appeals for the Tenth Circuit related to the Petitioner's claim of marital deduction provided for in Section 812(e)(1)(A, E, F, and H), respectively, of the Internal Revenue Code of 1939.

On June 6, 1947, the Decedent, Arthur Sweet, made and executed a trust agreement in writing whereby the Decedent created a revocable trust and designated the Tracy-Collins Trust Company as Trustee [Tr. of Record, p. 19]. Thereafter, on July 27, 1948, the Decedent and the Tracy-Collins Trust Company executed a supplemental trust agreement [Tr. of Record, p. 24].

The crucial question to be determined by the current litigation was whether one or two trusts were created by the supplemental trust agreement. In the pending controversy, Petitioner has contended that the legal effect of the supplemental trust agreement was to create two separate trusts over one of which trusts the Decedent's wife who survived him had power of appointment over the entire corpus while over the other trust she had no power of appointment. Respondent has contended throughout this litigation that only one trust was created by the supplemental trust agreement. Respondent in this controversy disallowed the claim of marital deduction upon the grounds that the surviving wife's power of appointment did not extend to the "entire corpus" of the single trust. It has been conceded throughout the litigation by the Respondent and recognized by the Tax Court and the United States Court of Appeals that if two separate trusts were created as Petitioner contended, then one of the two trusts, to-wit, the one over which the Decedent's wife had power of appointment, would properly qualify for the marital deduction. Likewise, Petitioner has conceded throughout the litigation and the Tax Court and the United States Court of Appeals have recognized that if only one trust was created, then Petitioner was not entitled to the marital deduction for the reason that the surviving wife's power of appointment did not extend to the "entire corpus" of such trust.

In the course of administration of the estate of the Decedent, the question of whether a single or two trusts were created first arose. The Tracy-Collins Trust Company, Petitioner herein, thereupon filed a Complaint in the District Court of the Third Judicial District, Salt Lake County, State of Utah, which court had sole and

exclusive jurisdiction over all matters relating to the interpretation and administration of the trust and estate of the Decedent and prayed for a judgment interpreting the trust instruments and adjudicating the question of all property rights and interests therein. The said District Court upon hearing and after notice to all interested parties in the estate and trust of the Decedent judicially determined that the aforesaid trust and supplement thereto constituted and created two separate trusts. That court found that over one of these trusts the Decedent's widow had power of appointment and over the other trust she had no power of appointment [Tr. of Record, pp. 12-17]. The complaint in the State Court named as defendants the widow and the surviving children of the Decedent. Appearances were filed by the widow and the children, but the matter was not contested by them. The Judgment of the State Court became final. No appeal had been taken from the said Judgment, and the Judgment has never been revoked, vacated or rescinded and remains in full force and effect to this date. The State Court Judgment is a final judgment binding upon the Petitioner herein, the surviving widow, and the children of the Decedent.

Notwithstanding the State Court's determination of the status of the trusts and the property rights of the Petitioner, the surviving spouse and the children of the Decedent, and the determination of that court that two separate trusts were created, the Respondent herein determined that but one trust was created. Such determination by the Respondent resulted in the disallowance of the marital deduction claim and the assessment of an estate tax deficiency.

Thereafter, Petitioner herein filed a Petition for Redetermination of the deficiency in the Tax Court of the United States [Tr. of Record, p. 3]. Trial was had before the Tax Court (a single judge hearing the matter) sitting in Salt Lake City on October 13, 1953. Upon conclusion of the trial, the Judge announced from the bench judgment in favor of the Petitioner and made oral findings that two separate trusts were created, and that the trust over which the widow was granted power of appointment qualified for the marital deduction [Tr. of Record, Document 7, pp. 27-29]. Thereafter, on the 24th day of June, 1955 (approximately 20 months later), the Tax Court (also by the same single judge) made and filed written Findings of Fact which are reproduced in the Transcript of the Record before this Court [Tr. of Record, Document 8, pp. 29-35]. The Tax Court, however, at this time changed its announced judgment and rendered judgment against the Petitioner. The Opinion and Judgment of the Tax Court is likewise reproduced in the Transcript of the Record [Document 8, pp. 35-40]. The Findings of Fact made by the Tax Court are not challenged and are adequately supported by the evidence. The Court of Appeals thereafter on Petition to Review the Decision of the Tax Court affirmed the Tax Court's judgment.

Questions Presented.

1. Where a state court renders a judgment interpreting trust instruments which judgment becomes final and binding on all parties thereto, is such judgment rendered ineffective for Federal tax purposes because the state court action was not contested by the beneficiaries?

2. What rules of interpretation should be uniformly followed in determination of whether one or two trusts are created by written trust instruments for Federal tax purposes?

Reasons for Granting Certiorari.

Petitioner herein respectfully urges the following reasons why certiorari should be granted in this case:

A. The Court of Appeals in this case has rendered a decision in conflict with the decisions of Courts of Appeals of other circuits on the same questions of law.

B. The Court of Appeals has decided an important question of Federal law which has not been but should be settled by this court.

C. The Court of Appeals had decided a Federal question in a way in conflict with applicable decisions of this court.

D. The questions involved are of general national importance in that they involve questions affecting the orderly administration of trusts and estates generally with special reference to the interrelationship between state courts' administration of trusts and the Tax Court's determination of taxability of estates and trusts and the Tax Court's determination of taxability of estates and trusts under provisions of the Internal Revenue Code.

Applicability of each of the aforementioned reasons to the instant case are set forth immediately hereafter under their appropriate subheadings.

A. The Court of Appeals in This Case Has Rendered a Decision in Conflict With the Decisions of Courts of Appeals of Other Circuits on the Same Questions of Law.

Two issues of law were presented to the Court of Appeals in this case. The first issue was whether or not the Judgment of the Utah State Court was an effective determination of the status of the trust estates and of the

property rights of the parties. The second issue was whether or not as a matter of law one or two trusts were created irrespective of the state court's judgment. As to each of these issues, the judgment of the Court of Appeals in this case is in conflict with judgments of Courts of Appeals of other circuits.

With reference to the first issue which was presented to the Court of Appeals in this case, namely, whether or not the Judgment of the state court was an effective determination of the status of the trusts and property rights of the parties, this question is the subject of a conflict of opinion between Courts of Appeals of several circuits. The Court of Appeals in the instant case held that because the state court action was not contested by the surviving spouse or the children of the decedent and was thus non-adversary in nature, the judgment of the state court was entirely ineffectual in this proceeding. This ground for rejection of the effectiveness of the state court judgment is directly in conflict with the opinion expressed by the Court of Appeals for the Third Circuit in the recent case of *Gallagher v. Smith*, 223 F. 2d 218. In analyzing the reported cases on the subject, that court noted that in the following cited cases no true adversary proceedings took place in the state court yet the judgments of state courts were given conclusive effect for tax purposes. These cases include *Blair v. United States*, 300 U. S. 5, 57 Sup. Ct. 330, 81 L. Ed. 465; *Sharp v. Commissioner*, 107 F. 2d 13, wherein certiorari was denied in 309 U. S. 665, 60 Sup. Ct. 591, 84 L. Ed. 1013; *Commissioner v. Crawford's Estate*, 139 F. 2d 616; *Bullard v. Commissioner*, 90 F. 2d 144; *Eisenmenger v. Commissioner*, 145 F. 2d 103. The Court of Appeals in the *Gallagher v. Smith* case, *supra*, held that the non-adversary nature of the proceeding is not, therefore, controlling. Yet in this case the

non-adversary nature of the proceeding was assigned as the reason for disregarding the state court's judgment. As was pointed out in the *Gallagher* case, the basic reason for holding the judgment of the state court to be conclusive is not to arbitrarily bind the United States taxing authority, but because of the fact that all parties to the state court action are themselves bound by the judgment, thus finally establishing their property and legal rights in the trusts. The court here took an opposite view. Whether or not the non-adversary nature of a state court proceeding will render ineffective a binding state court determination of trust is squarely in conflict among circuit courts of appeals for different circuits. To our knowledge, this court has not yet squarely passed upon this issue.

The Supreme Court has established several broad principals of law applicable to the present case. This court has held that as to the interpretation and administration of trusts, a judgment of the state court fixes and determines the property rights of the parties, and, as such, its judgments are binding upon the Commissioner of Internal Revenue and upon the Tax Court. (*Freuler v. Commissioner,* 291 U. S. 35, 78 L. Ed. 634, 54 Sup. Ct. 308; *Blair v. Commissioner,* 300 U. S. 5, 81 L. Ed. 465, 57 Sup. Ct. 330; *Helvering v. Stuart,* 317 U. S. 154, 87 L. Ed. 154, 63 Sup. Ct. 140.) This court also has held that state law creates legal interests and rights while the Federal Revenue Acts designate what interests or rights so created under state law shall be taxed. (*Morgan v. Commissioner,* 309 U. S. 78, 84 L. Ed. 585, 60 Sup. Ct. 424.) Likewise, this court has held that matters relating to powers, rights, and duties of trustees in connection with the interpretation, construction and validity of trusts are likewise peculiarly matters within the jurisdiction of the

State Courts. (*Hulburd v. Commissioner*, 296 U. S. 300, 80 L. Ed. 242, 56 Sup. Ct. 197.)

The seriousness of the problem created by the conflict of authorities among Courts of Appeals from the several circuits is sharply focused by the situation in this case. Here, a corporate trustee is confronted with a question of interpretation and administration of a trust. Serious administrative problems, the trustee's liability, as well as tax consequences depend upon its determination. It goes into the state court, the only forum open to it, and seeks a determination of its rights. Such procedure is expressly approved in the case of *Blair v. Commissioner, supra*. If the beneficiaries over whom the Trustee has no control contest the action, then according to the Court of Appeal's holding in this case, the state court's determination is apparently binding on the taxing authorities without question. But if there is no adversary action taken by the beneficiary, a conflict appears in the decisions of the Courts of Appeals as to whether or not the state court's determination is effective. This question has not been passed upon by the Supreme Court, and the conflict between Courts of Appeals leaves the question undecided.

In this case the Petitioner trustee acted in good faith to protect itself from conflicting interpretations as to the status of the trusts it was charged with administering. The statements in the Court of Appeal's Opinion that the state court action was instituted "for the sole and single purpose of circumventing the contention of the commissioner" and that the state court decree "was obtained by collusion for the purpose of maintaining the claim for marital deduction" are not supported by any evidence whatsoever, nor by anything else in the record, nor was any finding of fact made by the Tax Court with

reference to such asserted "collusive" conduct. [Tr. of Record, pp. 29-40.] It injects an issue of bad faith never even urged by the Respondent nor found to exist by the Tax Court nor supported by any evidence whatsoever. The true issue upon which there is, however, a serious and unreconcilable conflict is whether or not the absence of an adversary will destroy the effectiveness of a State court's judgment. Only this tribunal can settle this conflict.

As to the second issue, namely, what rules of interpretation should be applied, in similar factual situations the Courts of Appeals for the Third Circuit and the Sixth Circuit each determined that multiple trusts rather than a single trust were created by similar trust instruments. (*Union Trust Company of Butler v. Commissioner of Internal Revenue*, 84 F. 2d 386 (3rd Cir.); *Lucas v. Fidelity and Columbia Trust Company*, 89 F. 2d 945 (6th Cir.); *Fidelity Union Trust Company v. Kelly* 102 F. 2d 333 (3rd Cir.); *MacManus v. Commissioner*, 131 F. 2d 670 (6th Cir.); *United States Trust Co. of New York v. Commissioner*, 296 U. S. 481, 80 L. Ed. 340, 56 Sup. Ct. 329.) No uniformity as to rules of interpretation are followed by the different Courts of Appeal. The result reached by the courts below in this case are harsh and go squarely contrary to the clear intent of the Trustor in seeking to qualify his estate for the marital deduction authorized by law [Tr. of Record p. 39]. It thus appears that the very rules of interpretation upon which judicial determination of whether single or multiple trusts have been created in a given situation are the subject of differing standards and rules by different Courts of Appeals. Only this court can lay down rules of interpretation to be followed uniformly on this important subject.

B. The Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been but Should Be Settled by This Court.

The rule has been well established by the Supreme Court in the cases of *Freuler v. Commissioner, supra; Blair v. Commissioner, supra,* and *Helvering v. Stuart, supra,* that Federal Courts have no probate jurisdiction, and that state courts are under our system of jurisprudence solely vested with jurisdiction to determine the rights, duties, and obligations of parties in estates and trusts. (See *Hulburd v. Commissioner, supra.*)

This court has held that state law creates property rights which when so created become taxable or not under Federal statutes. (*Morgan v. Commissioner, supra.*) The Court of Appeals in this case placed a limitation on the rules heretofore announced by this Court, which limitation has not been heretofore sanctioned by this Court. It has stated that if the state court action is non-adversary in nature, then no property rights are effectively determined by the state court's decrees. This question has not been heretofore settled by this court. Carried to its logical conclusion, the Court of Appeals' decision holds in effect that a trustee is helpless to settle with finality its administrative problems or property rights in trusts for all purposes unless a beneficiary contests the action before the state courts. It is an important question which we respectfully submit has national implications, and in order to settle the same for all similarly situated trustees throughout the country as well as for the lower courts, this court should hear this matter and settle the problem.

C. The Court of Appeals Had Decided a Federal Question in a Way in Conflict With Applicable Decisions of This Court.

As was pointed out above, this court has held that State Courts properly are the forums to regulate administration of wills and trusts. (*Hulburd v. Commissioner, supra.*)

This court in the case of *Sharp v. Commissioner, supra,* denied certiorari where a Court of Appeals upheld a non-adversary state court judgment as effective for tax purpurposes. Likewise, in *Blair v. Commissioner, supra,* this court upheld a state court judgment also non-adversary in nature as binding upon the Federal taxing authorities. This court has laid down the rule in the case of *Morgan v. Commissioner, supra,* that state courts' determination of property rights under wills and trusts will be followed in Federal taxation matters. The Court of Appeals in this case seems to have rendered a decision here in conflict with the applicable decisions of this court. If the decision of the Court of Appeals is not in actual conflict with this court's decisions, its point of distinction is so obscure as to warrant clarification by this court by the granting of certiorari in this case.

D. The Questions Involved Are of General National Importance in That They Involve Questions Affecting the Orderly Administration of Trusts and Estates Generally With Special Reference to the Inter-relationship Between State Courts' Administration of Trust and the Tax Court's Determination of Taxability of Estates and Trusts and the Tax Court's Determination of Taxability of Estates and Trusts Under Provisions of the Internal Revenue Code.

Reference is made to the foregoing reasons for granting of the Writ for sake of brevity and to avoid redundancy.

Use of trusts are widespread throughout our nation. State courts must administer them under our system of jurisprudence. (See *Hulburd v. Commissioner, supra.*) Uniformity as to applicability of the State court judgments to Federal tax questions are not only desirable but essential to avoid a multiplicity of conflicting rules being followed by the various Courts of Appeals. The instant case adds to the confusion already existing as to the proper relationship of state and federal court judgments. Granting of certiorari is desirable not only to correct a harsh result in this case which twarted the Testator's clear intent to avail himself of the marital deduction [see Tax Court Opinion at p. 39 of the Tr. of Record] but also for the broader purpose of charting uniform rules for the administration of trusts by trustees and uniform applicability of laws by the Tax Court and Courts of Appeals.

Conclusion.

It is respectfully submitted that the Writ of Certiorari should be granted in this action.

Respectfully submitted,

MAURICE J. HINDIN,

Attorney for Petitioner.

APPENDIX.

United States Court of Appeals. Tenth Circuit. March Term, 1956.

Estate of Arthur Sweet, Deceased; Tracy-Collins Trust Company, Administrator, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 5235.

ON PETITION TO REVIEW THE DECISION
ON THE TAX COURT OF THE UNITED STATES

Maurice J. Hindin for Petitioner.

H. Brian Holland (Robert N. Anderson, I. Henry Kutz and David O. Walter were with him on the brief) for Respondent.

Before Bratton, Chief Judge, Murrah, Circuit Judge, and Hill, District Judge.

In 1947, Arthur Sweet executed a revocable trust agreement in the State of Utah, naming his wife and four children as beneficiaries. Tracy-Collins Trust Company was made trustee, and as such received the corpus of the trust estate.

This trust agreement provided among other things that the trustee should pay the income to the trustor during his lifetime and thereafter to trustor's wife for her lifetime; and upon the death of both trustor and his wife, the trust should terminate and the trust estate be distributed equally to trustor's four children with further provision for payment in a specific manner in event of the death of one or more of the children before the termination of the trust.

On July 27, 1948, the trustor executed an instrument denominated "Supplemental Trust Agreement". This instrument provided for the cancellation of paragraph IV of the original agreement and substituted a new paragraph therefor. The substituted paragraph provided trustor's wife should "have the power of appointment over such portion of the Trust Estate as equals one-half (½) of the value of my adjusted gross estate, as appraised for Federal Estate Tax purposes. The power of appointment of the said Margaret M. Sweet shall be exercisable in favor of herself, or in favor of her estate, or in favor of any other person, whom she shall elect to appoint. . . . In the absence of an appointment completely disposing of said portion of the Trust Estate, upon the death of said Margaret M. Sweet, said portion of the Trust Estate shall terminate and the Trustee shall pay, dispurse and distribute the same, in equal shares, unto the daughter of the Trustor, Barbara Sweet Hartman, the daughter of the Trustor, Margaret "Peggy" Sweet, and the son of the Trustor, Arthur David Sweet." The "Supplemental Trust Agreement" further provided that "The Remainder of the Trust Estate, over which the said Margaret M. Sweet has no power of appointment, shall terminate upon the death of the last survivor of the Trustor, and the said Margaret M. Sweet" . . .

Arthur Sweet died on October 21, 1952. A marital deduction from the gross estate of the decedent was claimed under section 812(e)(1)(F) of the Internal Reve-

nue Code of 1939, as amended by section 361 of the Revenue Act of 1948, c. 168, 62 Stat. 110.[1]

The Commissioner of Internal Revenue disallowed the claimed deduction and imposed a resulting deficiency in estate tax.

On August 22, 1952, and after the controversy arose over the estate tax deficiency, petitioner here filed an action in the District Court of the Third Judicial District of Utah to interpret and construe the two trust instruments. The primary beneficiary and the remaindermen under the instruments were named defendants and entered their appearances in that action. The Utah District Court entered judgment determining that the original trust agreement and the supplemental agreement created two trusts. Petitioner then filed its petition in the Tax Court seeking a redetermination of the estate tax deficiency. The deci-

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[1](F) Trust With Power of Appointment In Surviving Spouse.—In the case of an interest in property passing from the decedent in trust, if under the terms of the trust his surviving spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire corpus free of the trust (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the surviving spouse—

(i) the interest so passing shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

(ii) no part of the interest so passing shall, for the purposes of subparagraph (B)(i), be considered as passing to any person other than the surviving spouse.

This subparagraph shall be applicable only if, under the terms of the trust, such power in the surviving spouse to appoint the corpus, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

sion there was adverse to petitioners, 24 T. C. No. 55, and the proceeding was brought here on petition for review.

To decide the case, the legal effect of the two trust instruments must be determined insofar as federal estate tax liability is concerned.

The power vested in the surviving spouse to appoint only a part of the trust estate does not comply with the exaction of the statute requiring that she have power to appoint the entire corpus. Estate of Louis B. Hoffenberg, 22 T. C. 1185; affirmed Hoffenberg v. Commissioner, 223 F. 2d 470.

The petitioner seeks to meet this exaction of the statute by contending that the trustor set up two separate trusts. The argument proceeds on the level that the supplemental trust agreement modified the original agreement so as to create two separate and distinct trusts; that the surviving spouse was vested with power to appoint the entire corpus of the trust created by the supplemental agreement; and that in respect to such trust estate the marital deduction is well founded. But the trust instruments considered together do not lend themselves to that view. It is clear that the original instrument created a single trust with no power of appointment in the surviving spouse of the trustor. And the language contained in the supplemental trust agreement does not indicate a purpose to create two separate and distinct trust estates. It speaks throughout of the trust in the singular, not the plural. It expressly vests in the surviving spouse power of appointment over a portion of the trust estate. It provides that in the absence of an appointment completely disposing of such portion of the trust estate, the trust shall terminate and disbursements shall be made in the

manner specified. And it further provides that the remainder of the trust estate over which the surviving spouse has no power of appointment shall terminate upon the death of the last survivor of the trustor and his wife and disbursement shall be made in the manner therein detailed. The supplemental trust agreement indicates clearly a purpose to vest in the surviving spouse power of appointment over a part of a single trust, rather than to create two separate estates with power in the surviving spouse to appoint the entire corpus of one free of the trust and no power whatever to appoint the corpus of the other free of the trust.

The petitioner makes the further argument that the decision of the Utah State District Court declaring that two trusts were created is binding in this proceeding.

Legal rights and interest of parties in property are created and determined by state law but the manner in which and the extent to which such rights and interests shall be subjected to federal tax is determined by federal law. Morgan v. Commissioner, 309 U. S. 78; Broderick v. Gore, 224 F. (2d) 892; Broderick v. Moore, 226 F. (2d) 105.

While rights and interests of parties in property are created and determined by state law, an order or judgment of a state court obtained through collusion, or attended with some other badge or fraud, or entered in a nonadversary proceeding, is not binding as between one or more parties to such proceeding and the United States in respect to income or estate tax imposed by federal legislation. Broderick v. Gore, *supra;* Broderick v. Moore, *supra.*[2]

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[2]For a somewhat different and interesting discussion of this problem see Gallagher v. Smith, 223 F. (2d) 218.

The proceeding in the state court was instituted with the concurrence of the trustee and the beneficiaries under the trust for the sole and single purpose of circumventing the contention of the commissioner that the trustor did not create two separate and distinct trust estates, and it was essentially nonadversary in character. The decree was obtained by collusion for the purpose of maintaining the claim for marital deduction. And it therefore is not binding in this proceeding. Newman v. Commissioner, 222 F. (2d) 131.

The judgment of the Tax Court is AFFIRMED.

SEP 14 1956

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 318

ESTATE OF ARTHUR SWEET, DECEASED, TRACY-COLLINS TRUST COMPANY, ADMINISTRATOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 29–39) are reported at 24 T. C. 488. The opinion of the Court of Appeals (Pet. App. 1–6) is reported at 234 F. 2d 401.

JURISDICTION

The judgment of the Court of Appeals was entered on May 26, 1956. Taxpayer's petition for rehearing was denied on June 28, 1956. The petition for a writ of certiorari was filed on August 15, 1956. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTIONS PRESENTED

1. Whether the courts below erred in construing two trust agreements as creating one trust only.

2. Whether on the facts of this case the courts below were bound by the judgment of the District Court of the State of Utah that two separate trusts were created.

STATUTE AND REGULATIONS INVOLVED

The relevant statute and regulations, Section 812 (e) (1) of the Internal Revenue Code of 1939, and Section 81.47a (e) of Treasury Regulations 105, are set forth in the Appendix, *infra,* pp. 9–11.

STATEMENT

On June 6, 1947, Arthur Sweet, the decedent, executed a revocable trust agreement, with Tracy-Collins Trust Company as trustee. It provided in substance that the trustee should pay the income to the trustor for his life, and thereafter to his wife, for her life, and that, upon the death of both, the trust should terminate and the trust estate be distributed equally to his four children, with further provision for payment in a specific manner in the event of the death of any of the children before termination of the trust. (R. 19–24.)

In July, 1948, the decedent was advised that there would be a substantial savings in estate tax if Mrs. Sweet were given a power of appointment over one-half of the trust estate. (R. 31.)

On July 27, 1948, the trustor executed an instrument denominated "Supplemental Trust Agreement."

This instrument provided for the cancellation of paragraph IV of the original agreement and substituted a new paragraph therefor. The substituted paragraph provided that the trustor's wife should (R. 25)—

> have the power of appointment over such portion of the Trust Estate as equals one-half (½) of the value of my adjusted gross estate, as appraised for federal estate tax purposes. The power of appointment of the said Margaret M. Sweet shall be exercisable in favor of herself, or in favor of her estate, or in favor of any other person, whom she shall elect to appoint. * * * In the absence of an appointment completely disposing of said portion of the Trust Estate, upon the death of said Margaret M. Sweet, said portion of the Trust Estate shall terminate and the Trustee shall pay, disburse and distribute the same, in equal shares, unto the daughter of the Trustor, Dorothy Sweet Hindin, the daughter of the Trustor, Barbara Sweet Hartman, the daughter of the Trustor, Margaret "Peggy" Sweet, and the son of the Trustor, Arthur David Sweet.

The "Supplemental Trust Agreement" further provided that (R. 25)—

> The Remainder of the Trust Estate, over which the said Margaret M. Sweet has no power of appointment, shall terminate upon the death of the last survivor of the Trustor, and said Margaret M. Sweet * * *.

Provisions for the event that a child should predecease the trustor or his wife (R. 26) were identical with those in the original agreement (R. 21–22). The

"Supplemental Trust Agreement" provided further that (R. 26)—

> Except as herein specifically amended, modified or changed, the said Trust Agreement dated June 6, 1947, is hereby ratified and confirmed in all respects and particulars.

In administering the trust agreements, the trustee established and maintained records for only one trust, and filed only one fiduciary return in each of the years 1948 to 1951. (R. 32.)

Arthur Sweet died on September 29, 1948. (R. 30.)[1] A marital deduction from the gross estate of the decedent was claimed under Section 812 (e) (1) (F) of the Internal Revenue Code of 1939, as added by Section 361 of the Revenue Act of 1948, c. 168, 62 Stat. 110. The Commissioner disallowed the claimed deduction and imposed a resulting deficiency. Taxpayer filed a protest against the proposed deficiency on November 24, 1951. (R. 33.)

The controversy was over the question whether the trust agreement and supplemental trust agreement created one trust only or two separate trusts. It has been agreed in the courts below and here (Pet. 3) that if there were two separate trusts, the one over which Mrs. Sweet had the power of appointment would qualify for the marital deduction, and, on the other hand, that if only one trust was created taxpayer was not entitled to the marital deduction for the reason that the surviving wife's power

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[1] The opinion of the court below (Pet. App. 2) erroneously states this date as October 21, 1952.

of appointment did not extend to the entire corpus of the trust as required by statute.

On August 22, 1952, ten days after a conference with the representatives of the Commissioner on this issue (R. 8), taxpayer filed a complaint in the District Court of the Third Judicial District of Utah, requesting that court to interpret and construe the instruments as creating two separate trusts. (R. 33.) The decedent's wife and four children were named as defendants and given notice of the action. They filed an appearance but failed to answer or otherwise plead to the complaint and did not appear either in person or by counsel. At the trial taxpayer appeared by its attorney. The court rendered its judgment the same day, determining in almost the exact language of the suggestions set forth in the complaint that the original trust agreement and the supplemental agreement created two separate and distinct trusts. (R. 33–34, 36.)

The courts below concluded on the facts that the proceeding in the state court was instituted with the concurrence of the trustee and the beneficiaries under the trust for the sole purpose of circumventing the contention of the Commissioner that the trustor did not create two separate and distinct trust estates; that it was nonadversary in character and there was no real controversy between the parties and that the decision of the state court amounted to a consent decree. (R. 36–37; Pet. App. 5–6.)

Taxpayer then filed its petition in the Tax Court seeking a redetermination of the estate tax deficiency. (R. 3–6.) That court held that the trust instru-

ments showed an intention by the deceased to create only one trust and that it was not bound by the decision of the state court. (R. 35–39.) The Court of Appeals affirmed.

ARGUMENT

1. In interpreting the trust agreements the court below construed the two instruments together, and held that the supplemental agreement did not indicate a purpose to create two separate trusts. It pointed out that the agreement speaks throughout of the trust in the singular, not the plural, that it vests in the surviving spouse a power of appointment over a "portion" of "the Trust Estate," that upon the death of the trustor and his wife "the remainder of the trust estate" shall terminate.

In looking at the entire instrument to determine the trustor's intent and in giving weight to the use of the singular instead of the plural, the court here used the same method of interpretation as was followed in the cases cited by taxpayer (Pet. 10). Taxpayer asserts that there is no uniformity as to rules of interpretation followed by the different Courts of Appeals (Pet. 10). On the contrary, the courts, in the cases cited, are in substantial agreement as to the rules of interpretation. Those rules, applied to different trust instruments, have resulted in different conclusions as to whether there were several trusts or but one, the different conclusions arising not from varying rules of interpretation but from variances in the trust instruments.

The court below correctly applied those rules. Taxpayer is merely seeking a third judicial construc-

tion of a particular trust instrument. Review by this Court is not warranted, especially since similar problems in connection with the marital deduction are unlikely to arise in the future, the rule applicable to such cases having been changed by Congress by Section 2056 (b) (5) of the Internal Revenue Code of 1954.

2. The court below refused to give effect to the state court judgment that there were two separate trusts on the grounds that the state court proceeding was instituted for the single purpose of circumventing the ruling of the Commissioner that the trustor did not create two separate trust estates, that it was nonadversary in character, and that the decree was obtained by collusion for the purpose of maintaining the claim for marital deduction.

Taxpayer (Pet. 9–10) objects to this statement as to the collusive nature of the decree as unsupported by the evidence. It is apparent, however, that the Court of Appeals used the term as defined by this Court in *Freuler* v. *Helvering,* 291 U. S. 35, 45, as "collusive in the sense that all the parties joined in a submission of the issues and sought a decision which would adversely affect the Government's right to additional income tax." The record supports the court's holding that there was collusion in this special sense.

In holding that it was not bound by an order of a state court entered by collusion in a nonadversary proceeding the court below was also in accord with other Courts of Appeals. *Newman* v. *Commissioner,* 222 F. 2d 131 (C. A. 9th); *Estate of Rainger* v.

Commissioner, 183 F. 2d 587 (C. A. 9th), certiorari denied, 341 U. S. 904; *Green* v. *Commissioner,* 168 F. 2d 994 (C. A. 6th); *Saulsbury* v. *United States,* 199 F. 2d 578 (C. A. 5th), certiorari denied, 345 U. S. 906.

Contrary to taxpayer's contention (Pet. 7) the decision below is not in conflict with the decision of the Court of Appeals for the Third Circuit in *Gallagher* v. *Smith,* 223 F. 2d 218, for there the Third Circuit plainly agreed with the courts below here that a state court judgment obtained by collusion to defeat a federal tax need not be given conclusive effect in a suit in a federal court involving that tax, and the nonadversary character of a state suit is undoubtedly relevant as evidence of such collusion (p. 225).

CONCLUSION

The decision of the court below is correct, is in accord with the applicable decisions of this Court, and is not in conflict with the decision of any other Court of Appeals. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(e) [as added by Sec. 361 of the Revenue Act of 1948, c. 168, 62 Stat. 110] *Bequests, Etc., to Surviving Spouse.*—

(1) *Allowance of marital deduction.*—

(A) *In General.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * * * *

(F) *Trust with Power of Appointment in Surviving Spouse.*—In the case of an interest in property passing from the decedent in trust, if under the terms of the trust his surviving spouse is entitled for life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire corpus free of the trust (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the corpus to any person other than the surviving spouse—

(i) the interest so passing shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

(ii) no part of the interest so passing shall, for the purposes of subparagraph (B) (i), be considered as passing to any person other than the surviving spouse. This subparagraph shall be applicable only if, under the terms of the trust, such power in the surviving spouse to appoint the corpus, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

* * * * *

(H) *Limitation on Aggregate of Deductions.*—The aggregate amount of the deductions allowed under this paragraph (computed without regard to this subparagraph) shall not exceed 50 per centum of the value of the adjusted gross estate, as defined in paragraph (2).

* * * * *

(26 U. S. C. 812.)

Treasury Regulations 105, promulgated under the Internal Revenue Code of 1939:

SEC. 81.47a [as added by T. D. 5699, 1949-1 Cum. Bull. 181]. *Bequests, Etc., to Surviving Spouse.*—(a) *Allowance of marital deduction.*— * * *

* * * * *

(c) *Trust with power of appointment in surviving spouse.*—In the case of property interests which passed from the decedent to a trust, the terms of which satisfy the five conditions stated in this paragraph, the expression "passed from the decedent to his surviving spouse" embraces not only the beneficial interest therein of such spouse but also the interest therein

subject to her power to appoint. * * * The five conditions which must be satisfied by the terms of the trust are as follows:

> (1) The surviving spouse must be entitled for life to all the income from the corpus of the trust.
>
> (2) Such income must be payable annually or at more frequent intervals.
>
> (3) The surviving spouse must have the power, exercisable in favor of herself or of her estate, to appoint the entire corpus free of the trust.
>
> (4) Such power in the surviving spouse must be exercisable by such spouse alone and (whether exercisable by will or during life) must be exercisable in all events.
>
> (5) The corpus of the trust must not be subject to a power in any other person to appoint any part thereof to any person other than the surviving spouse.
>
> * * * * *

If the surviving spouse is entitled to only a portion of the trust income, or has power to appoint only a portion of the corpus, the trust fails to satisfy conditions (1) and (3), respectively. However, such conditions may be satisfied by one or more of several separate trusts created by the decedent. An undivided interest in property may constitute the corpus of a trust, and the will or a single trust instrument may create more than one trust.

* * * * *

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